

1973

# New Developments in Allocation of Income among Commonly Controlled Entities under Section 482

Minn. L. Rev. Editorial Board

Follow this and additional works at: <https://scholarship.law.umn.edu/mlr>



Part of the [Law Commons](#)

---

## Recommended Citation

Editorial Board, Minn. L. Rev., "New Developments in Allocation of Income among Commonly Controlled Entities under Section 482" (1973). *Minnesota Law Review*. 3028.  
<https://scholarship.law.umn.edu/mlr/3028>

This Article is brought to you for free and open access by the University of Minnesota Law School. It has been accepted for inclusion in Minnesota Law Review collection by an authorized administrator of the Scholarship Repository. For more information, please contact [lenzx009@umn.edu](mailto:lenzx009@umn.edu).

**Note: New Developments in Allocation of Income  
Among Commonly Controlled Entities  
Under Section 482**

**I. INTRODUCTION**

Section 482 of the Internal Revenue Code<sup>1</sup> vests broad discretionary power in the Commissioner to readjust the stated income and expenses of commonly controlled taxpayers. It provides:

In any case of two or more organizations, trades or businesses (whether or not incorporated, whether or not organized in the United States, and whether or not affiliated) owned or controlled directly or indirectly by the same interests, the Secretary or his delegate may distribute, apportion, or allocate gross income, deductions, credits, or allowances between or among such organizations, trades, or businesses, if he determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any of such organizations, trades, or businesses.

To justify a Section 482 allocation, then, the Commissioner must find that (1) there are two or more "organizations, trades, or businesses" (2) "owned or controlled" by the "same interests" and (3) that the allocation is necessary to prevent tax evasion or to clearly reflect income. Prevention of tax evasion and clear reflection of income are independent bases for asserting Section 482.<sup>2</sup> Thus the Commissioner's power is not limited to cases of tax evasion but may be invoked in any case where, by inadvertence or design, there has been a diversion of income through non-arm's length transactions<sup>3</sup> from the entity which generated

---

1. INT. REV. CODE of 1954.

2. *Central Cuba Sugar Co. v. Commissioner*, 198 F.2d 214 (2d Cir.), *cert. denied*, 344 U.S. 874 (1952). Treas. Reg. § 1.482-1(c) (1968).

3. The regulations provide that the standard to be used in judging the propriety of transactions between commonly controlled entities is that of an uncontrolled taxpayer dealing at arm's length with another uncontrolled taxpayer. Treas. Reg. § 1.482-1(b)(1) (1962). While the courts have generally upheld the use of the arm's length standard, *see, e.g., Eli Lilly & Co. v. United States*, 372 F.2d 990 (Ct. Cl. 1967), some recent decisions in the area of intercompany pricing might be read to permit the use of other tests by taxpayers to justify less than strict arm's length dealings. *See, e.g., PPG Industries, Inc.*, 55 T.C. 928 (1970); *Greene & Hobbet, Substantial Business Activity, Reasonable Allocations Needed to Thwart 482 Adjustment*, 34 J. TAXATION 113 (1971); *Morrione, Lilly to Lufkin—An Interpretation of Court Thinking on Intercompany Pricing*, 3 TAX ADVISER 74 (1972). Some commentators, however, see any differences in approach as "probably more of a semantic nature

it to another entity within the controlled group.<sup>4</sup>

An example of Section 482 allocation may be helpful at this point. A and B are brother-sister corporations. A sells goods to B at cost, whereas it would have charged an unrelated party a higher price. The purpose of the transaction is to take full advantage of B's net operating loss carryovers by thus shifting taxable income from A to B when B resells the goods at arm's length prices. The application of the arm's length standard would dictate that, for tax purposes, a portion of B's income be allocated to A with B's income being reduced accordingly. A and B would be taxed as if A had earned the income allocated to it thus resulting in an increase in the total taxes paid by the controlled group. Once made, the Commissioner's allocation will be reversed only if the taxpayer carries the heavy burden of proving it to be arbitrary or capricious.<sup>5</sup>

An allocation may also involve adverse collateral consequences, foremost of which is the threat of constructive dividend treatment. Since a Section 482 allocation entails only a transfer of the tax incidents of the income allocated, A's income, in the above example, is increased for tax purposes though the funds themselves remain with B. The Commissioner's position has been that this should be reflected by viewing the transaction as a dividend distribution, made by A to the controlling shareholder, in an amount equal to the difference between an arm's length price and the bargain price. In theory, this would be followed by a capital contribution in that amount from the shareholder to B.<sup>6</sup> Under this view, the shareholder could also incur

---

than of practical substance." B. BITTKER & J. EUSTICE, *FEDERAL INCOME TAXATION OF CORPORATIONS AND SHAREHOLDERS* 15-29 (3d ed. 1971). This interpretation is supported by the recent decision in *Lufkin Foundry and Mach. Co. v. Commissioner*, 468 F.2d 805 (5th Cir.), *rehearing denied*, 468 F.2d 808 (5th Cir. 1972).

4. "The term 'controlled taxpayer' means any one of two or more organizations, trades, or businesses owned or controlled directly or indirectly by the same interests." Treas. Reg. § 1.482-1(a)(4) (1962). "The terms 'group' and 'group of controlled taxpayers' mean the organizations, trades, or businesses owned or controlled by the same interests." Treas. Reg. § 1.482-1(a)(5) (1962).

5. *Asiatic Petroleum Co.*, 31 B.T.A. 1152, *aff'd*, 79 F.2d 234 (2d Cir. 1935).

6. Rev. Rul. 69-630, 1969-2 CUM. BULL. 112; Rev. Proc. 65-31, § 4.04(3), 1965-2 CUM. BULL. 1024, 1037. See Jenks, *Constructive Dividends Resulting from Section 482 Adjustments*, 24 TAX LAWYER 83 (1970). However, the courts have not upheld constructive dividend treatment where the intercorporate transaction: (1) was motivated by a corporate business purpose, rather than a tax avoidance purpose or

a tax liability.<sup>7</sup> A possible collateral consequence for a personal holding company is that its personal holding income may be increased above permissible levels by an allocation, subjecting undistributed amounts to a penalty rate.<sup>8</sup> And if one member of a controlled group is a Western Hemisphere trade corporation, an allocation from it may reduce its income below the required levels, causing it to lose the special deduction granted such corporations.<sup>9</sup> In short, the possible collateral consequences are both numerous and severe for several classes of taxpayers when a Section 482 allocation is made.<sup>10</sup>

Since much has already been written on Section 482,<sup>11</sup> this Note will be limited to current developments in the effort to delineate the boundaries of the Commissioner's power.<sup>12</sup> The discussion will focus on (1) the scope of the requirement of "two

---

a personal objective of the common shareholder; and (2) produced no benefit or only an incidental rather than a direct benefit to the shareholder. Loening, *Section 482 Allocations Resulting in the Creation of Income or in Constructive Dividends to Shareholders*, 30 INST. FED. TAXATION 1247 (1972).

7. Although the term "constructive dividend" is used, the tax treatment of amounts constructively distributed should be determined under Section 301(c). Thus, a distribution would be a dividend under Section 316 only to the extent of the earnings and profits of the corporation which is deemed to have made the distribution.

8. INT. REV. CODE OF 1954, § 541. This result is specifically indicated in Treas. Reg. § 1.482-1(d)(3) (example 3) (1968).

9. INT. REV. CODE OF 1954, §§ 921, 922.

10. See generally Aland, *Section 482: 1971 Version*, 49 TAXES 815, 833 (1971); O'Connor, *Side Effects of Section 482 Can Be More Serious Than Original Allocation*, 31 J. TAXATION 194 (1969).

11. A complete listing at this point would not be useful, but for a general overview of the section see the following: B. BITTKER & J. EUSTICE, *supra* note 3, at ¶ 15.06; Aland, *supra* note 10; Asbill, *The Application of Section 482 to Domestic Taxpayers—Current Status and Trends*, 1967 SO. CALIF. TAX INST. 673; Eustice, *Tax Problems Arising from Transactions Between Affiliated or Controlled Corporations*, 23 TAX LAW REV. 451 (1968); Seieroe & Gerber, *Section 482—Still Growing at the Age of 50*, 46 TAXES 893 (1967).

12. This conflict has intensified in recent years. Although Section 45 of the Revenue Act of 1928 contained language almost identical to that of present Section 482, the Commissioner rarely used it, and the section became known as the "silent policeman." In the 1950's, resort to this power in the foreign area was more frequent, especially following audit activities of the Office of International Operations. In the last few years, a steady increase in the application of Section 482 to foreign operations has been followed by its expanded use in purely domestic areas. For a history of the section, see Spaeth, *Section 482—Past and Future*, 47 TAXES 45 (1969). See generally J. SEIDMAN, *SEIDMAN'S LEGISLATIVE HISTORY OF FEDERAL INCOME TAX LAWS* (1953-39) (1954); J. SEIDMAN, *SEIDMAN'S LEGISLATIVE HISTORY OF FEDERAL INCOME TAX LAWS* (1938-1861) (1938).

or more organizations, trades, or businesses"; (2) the shifting emphasis in the common control requirement; and (3) the Commissioner's attempted use of Section 482 to "create" rather than allocate existing income. Thereafter, the discussion will deal with the appropriate sphere for Section 482's operation in relation to other Code sections and judicially established tax principles.

## II. STATUTORY REQUIREMENTS

### A. THE REQUIREMENT OF TWO OR MORE ORGANIZATIONS, TRADES, OR BUSINESSES

Section 482 applies only where there are two or more "organizations, trades, or businesses." As a result of the broad scope of these terms<sup>13</sup> and the exhaustive coverage of the regulations,<sup>14</sup> this requirement has not been the subject of much litigation. Uncertainty and conflict have often arisen, however, when the Commissioner attempts to allocate income from a closely held corporation to a shareholder-employee. The regulations specifically include sole proprietorships within the scope of Section 482,<sup>15</sup> so that income earned by an individual's sole proprietorship but arbitrarily shifted to a corporate enterprise under his control may be allocated back to the proprietorship. What is not clear under either the statutory language or the regulations is whether Section 482 also applies where an individual performs services as an employee of his corporation. In these situations, the issue is whether the individual is an "organization" or his rendition of services constitutes a "trade or business" separate from the corporation so that two entities are present.

---

13. Indeed, the term "organization" was added to the Code by the Revenue Act of 1934 specifically to remove any doubt as to the application of this section to all kinds of business activity, H.R. REP. NO. 704, 73d Cong., 2d Sess. 24 (1934).

14. The term 'organization' includes any organization of any kind, whether it be a sole proprietorship, a partnership, a trust, an estate, an association, or a corporation (as each is defined or understood in the Internal Revenue Code or the regulations thereunder), irrespective of the place where organized, where operated, or where its trade or business is conducted, and regardless of whether domestic or foreign, whether exempt, whether affiliated, or whether a party to a consolidated return. Treas. Reg. § 1.482-1(a)(1) (1962). "The term 'trade' or 'business' includes any trade or business activity of any kind, regardless of whether or where organized, whether owned individually or otherwise, and regardless of the place where carried on." Treas. Reg. § 1.482-1(a)(2) (1962).

15. Treas. Reg. § 1.482-1(a)(1) (1962).

1. *Application of Section 482 to an Individual  
Independently Producing Income*

In *Borge v. Commissioner*,<sup>16</sup> the Second Circuit upheld an allocation where the shareholder of a shell corporation attempted to offset unrelated personal income by channeling the personal income and transferring the net operating losses of his sole proprietorship to the corporation. The taxpayer conducted an unsuccessful poultry operation (ViBo Farms) as a proprietorship. Due to individual loss deductions previously taken, continued losses would have subjected Borge to recomputation of tax under existing hobby farm provisions.<sup>17</sup> He therefore transferred the operation to Danica, a newly formed and wholly owned corporation. Borge then entered into a personal service contract authorizing Danica to sell his artistic services on television, radio, and in theatrical performances for a yearly fee of \$50,000. Danica sold Borge's services to third parties, realizing an average net income of \$166,465, but paying Borge nothing during four of the years in question.

The Commissioner determined that Borge actually controlled two separate businesses, ViBo Farms and his own entertainment business, and allocated a portion of the entertainment income to him. Borge argued that his entertainment services did not constitute a separate organization, trade, or business under Section 482. He relied on the Second Circuit's own decision in *Commissioner v. Gross*,<sup>18</sup> where it ruled that shareholder-officers of a close corporation could render services to it without compensation and without treatment of their capital withdrawals as salaries. However, the Second Circuit concluded that the Commissioner correctly found Borge in control of two separate

---

16. 405 F.2d 673 (2d Cir. 1968), *aff'g, modifying and remanding* 26 CCH Tax Ct. Mem. 816 (1967), *cert. denied*, 395 U.S. 933 (1969).

17. ViBo Farms was heading for its fifth consecutive year of losses in excess of \$50,000, which would have triggered recomputation of tax under Section 270 of the Code. (Repealed by Act of Dec. 30, 1969, Pub. L. No. 91-172, § 213(b), 83 Stat. 572).

18. 236 F.2d 612 (2d Cir. 1956). *Gross* involved cash distributions to the shareholders of several construction corporations, including three experienced builders who also acted as president, secretary, and treasurer of the corporations. The distributions were supported by a surplus created when the corporations revalued their real estate to reflect appreciation. The Second Circuit rejected the Commissioner's contention that amounts distributed in excess of current and accumulated earnings and profits were anticipatory distributions of future profits and should therefore be taxed as ordinary income. It also refused to treat any portion of the distributions to the officer-shareholders as salaries or fees for the services they rendered.

businesses and upheld the partial allocation.<sup>19</sup> It distinguished *Gross* on the ground that Borge was not devoting his efforts to Danica in the hope of enhancing his investment in the corporation but was merely continuing his individual entertainment business and channeling ordinary income through the corporation.<sup>20</sup>

The court apparently felt that the essence of the entertainment business remained with Borge and was not transferred to Danica.<sup>21</sup> In this regard, the nature of the services rendered seemed to be of primary significance. Borge possessed unique artistic abilities totally unrelated to the rest of Danica's operations, and his prior individual earnings attested to the fact that he was capable of generating income independent of the corporation's operations. In *Gross*, by contrast, the three individuals who controlled the corporation performed services which admittedly required a certain amount of expertise but which were valuable only insofar as they contributed to the production of income by the corporation as a whole.<sup>22</sup>

Although the *Borge* decision was significant in allowing application of the organization, trade, or business concept to an individual, it did not represent a radical extension of Section

---

19. 405 F.2d at 675.

20. *Id.* at 676. Borge also relied on *Whipple v. Commissioner*, 373 U.S. 193 (1963). There, the Supreme Court held that furnishing organizational, promotional and managerial services to corporations for an economic benefit equivalent to that which would flow to an investor in those corporations is not a trade or business. It thus characterized losses incurred by a sole shareholder in connection with such activities as capital rather than ordinary losses. Apparently, Borge placed primary reliance on *Whipple* rather than *Gross*, although the latter is more relevant to the issue of whether an individual should be treated as a separate income generating entity. While both decisions deal with the existence or nonexistence of a "trade or business," that term has different connotations when used in connection with the deductibility of losses and nonbusiness debts. The court, however, distinguished *Whipple* and *Gross* on the same grounds.

21. The court emphasized that Danica did nothing to earn or assist in earning the entertainment income and that those contracting with Danica required Borge's personal guarantee. The Tax Court had similarly concluded:

[T]here was no change in the conduct of his entertainment business after [Danica's incorporation]. Its earnings were attributable to the services of Victor.

26 CCH Tax Ct. Mem. 816, 820 (1967).

22. Similarly, this situation was not like that in *Whipple* where the shareholder's activities were confined to transactions necessary to provide equipment and financing for a new corporate business, the reward for such services being contingent upon the corporation's subsequent successful operation.

482.<sup>23</sup> The situation there strongly resembled that in which income is shifted from a proprietorship to a commonly controlled close corporation, a situation which is clearly covered by the Regulations. Consequently, the court was not forced to consider the Commissioner's more expansive suggestion that a shareholder-employee might always constitute a separate organization, trade, or business for Section 482 purposes.<sup>24</sup>

2. *Expansion of the Organization, Trade or Business Concept to Traditional Employment Relationships*

The decisions in two other cases expanded the scope of Section 482 to a point where the Commissioner's suggestion must be seriously considered. Unlike *Borge*, both cases involved individuals who seemed to fit the traditional employee concept, but in each case an allocation of income from the corporate employer to the individual was upheld. In *Pauline W. Ach*,<sup>25</sup> the sole proprietress of a profitable dress shop sold its assets to a family corporation which had sustained substantial operating losses in the dairy business. Although the sale agreement did not contain an employment contract to render further services, Ach continued to actively conduct the dress business without receiving a salary from the corporation. For four years, the net operating loss carryovers of the defunct dairy business were used to offset the earnings of the dress business.<sup>26</sup> The Tax Court rejected the Commissioner's allocation of all the corporation's profits for these years to Ach, but it did determine that a partial allocation was appropriate.

The crux of the Tax Court's opinion was that Ach retained the vital aspects of the dress business, despite the transfer of its tangible assets to the corporation. The court reasoned that the single most important element of the successful business was Ach's active participation as "manager and guiding spirit." This had not been transferred to the corporation, as evidenced by the fact that she was neither bound to it by an employment

---

23. See Kauder, *The Service Corporation as the Taxpayer's Alter Ego: Variations on the Borge Theme*, 28 N.Y.U. 28TH INST. ON FED. TAX. 1109 (1970).

24. Brief for Commissioner at 24, *Borge v. Commissioner*, 405 F.2d 673 (2d Cir. 1968); cited in Kauder, *supra* note 23, at 1134.

25. 42 T.C. 114 (1964), *aff'd*, 358 F.2d 342 (6th Cir.), *cert. denied*, 385 U.S. 899 (1966).

26. This facilitated payment out of current profits of a non-interest bearing demand note given Ach for the dress business assets as well as other corporate notes given for previous advances by the father.



contract nor prohibited by a covenant not to compete. The court therefore found that Ach herself was, in a sense, still a separate entity.<sup>27</sup>

In the most recent decision in this area, *Richard A. Rubin*,<sup>28</sup> the Tax Court again upheld application of the organization, trade, or business concept to an individual rendering only management services. Rubin obtained an option to purchase a majority interest in Dorman Mills, a textile corporation which had been operating at a loss. To revitalize Dorman, Rubin formed another corporation (Park) in which he received a majority interest. The purpose of the corporation ostensibly was to deal in art works. Park and Dorman then entered into a contract whereby Park would provide Rubin's management services to Dorman. Rubin received considerably less in salary from Park than Park received in management fees from Dorman and the Commissioner allocated the difference to him.

As in *Ach* and *Borge*, the taxpayer argued that he was a mere employee devoting his efforts only for the sake of his investment in Park. In addition, Rubin had an argument not available in *Ach* and *Borge*: unlike the individuals in those cases, he had not previously engaged in business in proprietorship form, so it could not be maintained that he was continuing the operation of what was clearly a trade or business prior to the formation of his corporation. He warned that to uphold an allocation here would mean that the Commissioner could always treat corporate employment as a separate trade or business under Section 482 in order to increase the inadequate salaries of corporate employees.

The Tax Court rejected these contentions, relying heavily on *Ach* and *Borge*. It determined that Rubin was not merely an employee of Park but was engaged in an independent trade or business, the rendering of management services to Dorman.<sup>29</sup> Previous operation in proprietorship form was not regarded as

---

27. The court observed:

Pauline certainly conducted *Vogues* and *Vanities* as an individual prior to August 1, 1953, and, as such, she was a taxpayer of the character referred to in Section 482. Similarly, the corporation is a separate taxpayer covered by this statute. And Pauline did not cease to be a separate taxpayer or "organization," "trade," or "business" within the purview of these provisions by reason of her "sale" of the naked assets of the dress business to the corporation.

42 T.C. at 124.

28. 56 T.C. 1155 (1971), *aff'd*, 460 F.2d 1216 (2d Cir. 1972).

29. His management services, declared the court, were the "clear counterpart" of *Borge's* entertainment services. 56 T.C. at 1159.

pivotal, but as merely one of many factors to be considered. The court found more persuasive the fact that Rubin's services were rendered to parties other than his putative employer. Moreover, since he had no contract with Park, he could freely have terminated its right to receive compensation for his services, thus retaining complete control over the corporation's production of income.<sup>30</sup> The court concluded:

We merely hold, as is the clear import of both the *Ach* and *Borge* decisions, that where the *particular facts* of a case are such as to justify a finding that a shareholder operated an independent business and merely assigned to the corporation a portion of the income therefrom, the business activity of the taxpayer may constitute a trade or business to which allocation of all or part of the income attributable to his efforts is authorized under Section 482.<sup>31</sup>

Both *Ach* and *Rubin* can be viewed as expanding the scope of Section 482 through a liberal application of the organization, trade, or business concept to shareholder-employees of close corporations. The former decision appears to be more significant in terms of future development. Unlike the entertainment activities in *Borge*, *Ach*'s managerial activities were directly related to the operation of the corporate dress business. Moreover, her management services were not income-producing alone, but were of the type traditionally rendered to an employer and depended upon the corporation's assets and labor. In short, *Ach* was much more similar to the shareholder-officers in a typical close corporation than she was to an individual diverting income from one business entity to another. Basically, her maneuvers involved the incorporation by an individual of a going business, a practice recognized under the Code as a legitimate course of action.<sup>32</sup> There were, of course, obviously unauthorized tax avoidance motives for the incorporation, but a more appropriate remedy would have been the disallowance of the net operating loss carryovers under Section 269.<sup>33</sup>

The *Rubin* decision seems to affirm the liberal application of Section 482, but on facts less extreme than those in *Ach*. *Rubin*,

---

30. *Id.* at 1160.

31. *Id.* at 1161 (emphasis added).

32. A taxpayer is generally privileged to decrease or even avoid taxes through incorporation so long as the substance and form of the transaction coincide. See, e.g., *Gregory v. Helvering*, 293 U.S. 465 (1935).

33. Section 269 authorizes the Commissioner to disallow corporate deductions, credits, or allowances where the securing of such benefits for tax avoidance or evasion was the principal purpose for acquisition of the corporation. In fact, this section was successfully invoked by the Commissioner here in addition to Section 482.

too, was engaged in management activities not in themselves income producing, but, like Borge, he was rendering services to another party which were totally unrelated to his employer's art business. *Rubin* is most significant for the Second Circuit's dictum concerning the possible expansion of Section 482. Like the other courts which considered this issue, it refrained from stating whether a shareholder-employee may always be treated as a separate entity under Section 482.<sup>34</sup> But in response to Rubin's argument that such would be the effect of affirming the allocation, the court commented that "the prospect is not so shocking to us as to (Rubin's) counsel."<sup>35</sup>

### 3. *Current Standards, Future Threats*

Despite the Second Circuit's dictum in *Rubin*, it does not appear that the courts are ready to extend the organization, trade, or business concept to all individuals rendering services to closely held corporations in which they are shareholders. *Borge* and *Rubin* indicate that income will usually be allocated where the individual's services are the sole factor in the generation of an independent stream of income and there is a significant disparity between that income and the individual's salary. Where the individual performs services which are merely a component of the single identifiable corporate business, an allocation is presumably less likely. Unfortunately, since the *Rubin* decision, both situations will apparently be governed by the same vague "particular facts" test.

#### a. The "Particular Facts" Test

As articulated by the court in *Rubin*, an allocation to an individual under Section 482 will be upheld where the "particular facts" of the case justify it. In affirming, the Second Circuit failed to adopt this specific language but nevertheless took a similar approach in its own handling of the case, indicating that it would continue to decide other cases on their particular facts. Given the apparently imprecise nature of the organization, trade

---

34. Like the Tax Court, it concluded that, on these facts, the taxpayer was not a mere employee but rather the renderer of independent services, stating:

It was Richard Rubin's special ability that Dorman wanted, and it wanted nothing else from Park insofar as management services were concerned. This is enough to constitute his rendition of services for compensation a trade or business. . . . Other cases will be decided when they arise.

460 F.2d 1216, 1218.

35. *Id.*

or business concept, it seems clear that this ad hoc approach will continue.

The above mentioned opinions cite several factors which appear to be significant under the "particular facts" test. The absence of a binding employment contract and the existence of special skills or talents may be sufficiently indicative of an income producing capability separate from the corporation's to support an allocation. Such services may include not only entertainment or other professional skills but also management or entrepreneurial expertise. Previous operation as a proprietorship has also been cited as important but, since *Rubin*, is apparently no longer a major factor. The number of shareholders rendering services and the entity to which the services are rendered may also be important. In each of the three cases, there was only one individual rendering the services which produced or contributed to the corporation's income. This fact situation, in contrast to those situations where the activities are divided among several shareholders, indicates that the individual alone is the income generator rather than the corporation. In *Rubin* and *Borge*, the Tax Court indicated that it may rely on the fact that services are rendered directly to third parties rather than to the individual's own corporation. If the latter is a primary factor, then the common business practice of "lending" employee services is vulnerable.<sup>36</sup> A final factor is the existence of a tax avoidance motive for incorporation. Although tax avoidance is technically irrelevant in the application of Section 482,<sup>37</sup> where such motive is the primary reason for incorporation, it is likely that it will bear on the court's decision. In fact, a finding that the shareholder-employee constitutes a separate trade or business is, in effect, a determination that his activities go beyond permissible limits of tax minimization through incorporation.

Even if these are the significant factors in determining whether an allocation will be upheld, prediction of a court's reaction to a specific situation is difficult under the "particular

---

36. The traditional view has been that a loaned employee performing services for another is merely a conduit through which compensation flows to the employer. Thus, the compensation remains taxable to the employer and not to the loaned employee, who is compensated through his usual salary. Lyon & Eustice, *Assignment of Income: Fruit and Tree as Irrigated by the P. G. Lake Case*, 17 TAX LAW REV. 293, 391-93 (1962).

37. For example, the Tax Court in *Rubin* rejected the absence of a tax avoidance motive for incorporation as a ground for distinguishing *Ach* and *Borge*. 56 T.C. at 1159.

facts" test, since no single factor is controlling. In addition, there has been no indication of how many such factors must be present to support application of the organization, trade, or business concept, nor is it clear that the above factors are the only possible ones.

b. Possibilities for Expansion of the Trade or Business Concept

The *Ach* decision represents the most expansive application of Section 482 in this area, but it is a relatively old decision and no recent case has gone quite as far. Nevertheless, the Second Circuit's dictum in *Rubin* leaves open the possibility that the rationale of the personal service cases could be extended beyond *Ach* to a holding that any shareholder-employee of a corporation is subject to an allocation under Section 482 where salaries are low or nonexistent. In *Gross*, the Second Circuit explicitly stated that the officers of a corporation are not compelled to take salaries for their services. In *Borge*, *Ach*, and *Rubin* the courts nevertheless upheld allocations which indirectly effected just such a result, even though in two of the cases the allocations were in excess of contractually established salaries.<sup>38</sup>

Several other Code sections also use the "trade or business" language.<sup>39</sup> Since it has been held under some of these that being an executive officer of a corporation may constitute a trade or business,<sup>40</sup> a court could reason that a shareholder-employee of a close corporation is in a trade or business for Section 482 purposes. The court could take the position that the term should be uniformly interpreted throughout the Code or, if this is unrealistic,<sup>41</sup> that the conceptual frameworks are similar enough to at least allow application of judicial concepts developed under other sections to Section 482. On the other hand, this broad rule

---

38. See Treas. Reg. § 1.482-1(a)(6) (1962), which specifically states that "true taxable income" is not limited to contractually set amounts.

39. See, e.g., INT. REV. CODE of 1954, §§ 162, 165, 166, 174, 355, 356, 864, 1402. See generally 4A J. MERTENS, LAW OF FEDERAL INCOME TAXATION § 25.08 (rev. ed. 1966).

40. See, e.g., *Mitchell v. United States*, 408 F.2d 435 (Ct. Cl. 1969); *David J. Primuth*, 54 T.C. 274 (1970). For a discussion of judicial expansion of the "trade or business" concept in this area, see Note, *Federal Income Tax Treatment of Business and Employment Investigatory Expenses*, 56 MINN. L. REV. 1157 (1972).

41. The multitude of different situations in which the term "trade or business" is used would make the formulation of a comprehensive definition nearly impossible. Notably, the Service has never published regulations defining the term.

would still likely be subject to limitations. Sporadic and infrequent duties or strictly investment activities, for example, have been held not to constitute a trade or business under other Code provisions.<sup>42</sup>

Since the regulations<sup>43</sup> give the Commissioner the power to set compensation at an arm's length amount for services rendered between controlled entities, recognizing the shareholder-employee as a separate entity would apparently allow the Commissioner to directly raise his salary upward to such an amount.<sup>44</sup> This action could have further severe consequences if the Commissioner would then take the position that reallocated income does not qualify as employee compensation for purposes of contributions or benefits under a qualified employee pension plan.<sup>45</sup>

The effects of such a broad application of Section 482 may be far reaching. Many closely held corporations make bonus or compensation payments to their shareholder-officers either at the end of the current taxable year or at the beginning of the next, depending on the individual's tax situation. In *Robert A. Boyer*,<sup>46</sup> however, the Tax Court recently approved the use of Section 482 to disregard a delay or acceleration of payments between controlled taxpayers if it results in a tax benefit which does not clearly reflect income.<sup>47</sup> In light of *Rubin and Boyer*, the Commissioner may be expected to use Section 482 to eliminate the ability to time the receipt of income to a shareholder-employee. Similarly, the Service has conceded that lawyers,

---

42. Jack P. Stanton, 26 CCH Tax Ct. Mem. 618 (1967), *aff'd*, 399 F.2d 326 (5th Cir. 1968); Percy S. Winfield, 25 CCH Tax Ct. Mem. 305 (1966), *aff'd*, 19 Am. Fed. Tax R.2d 627 (7th Cir.), *cert. denied*, 389 U.S. 851 (1967).

43. Treas. Reg. § 1.482-2(b) (1) (1968).

44. See Katz, *Can Section 482 Be Used to Negate the Tax Effect of a Bona Fide Corporation?*, 28 J. TAXATION 2, 4 (1968). The Commissioner already has the power to indirectly adjust such salaries downward by merely disallowing part of the corporation's deduction under Section 162(a) (1).

45. Sections 401-406 of the Code provide the rules for establishing and maintaining qualified pension plans. See generally Horseley & Dray, *Compensating Officer-Stockholders of Professional Corporations: An Analysis*, 34 J. TAXATION 146 (1971).

46. 58 T.C. 316 (1972).

47. The court upheld an allocation where a lessor allowed its commonly owned lessee to defer the payment of rent due during the years in issue. The lessee offset its income, which was increased by the elimination of the rent expense, with losses from another venture. The taxpayers in *Boyer* were a corporation and a limited partnership, but the same result could be reached in regard to a corporation and a shareholder-employee who is treated as a separate entity.

physicians and other professionals who organize under professional corporation statutes will be treated as corporations for tax purposes.<sup>48</sup> As a result of the development in this area, however, Section 482 may be available to the Commissioner for corrective action where income is being arbitrarily diverted from an individual to the corporation. Instead of trying to get a professional service corporation disregarded as a sham, the Commissioner might attempt to allocate a portion of the corporation's income to one or more of the professionals.<sup>49</sup> Although the tax consequences of an allocation are generally less harsh than those resulting where the corporate entity is disregarded,<sup>50</sup> the possibility of such action still poses a significant threat.

#### B. THE COMMON OWNERSHIP OR CONTROL REQUIREMENT

For Section 482 to be operative, the two or more entities must be "owned or controlled directly or indirectly by the same interests." Such language lends itself to broad and indefinite application.<sup>51</sup> The use of the disjunctive in "owned or controlled" suggests that the existence of either element alone is sufficient to support an allocation. This in itself is a deviation from the approach in other Code sections which generally combine these two elements and define control in terms of ownership.<sup>52</sup> Neither term is adequately defined for Section 482 pur-

---

48. Rev. Rul. 70-101, 1970-1 CUM. BULL. 278, as amplified, Rev. Rul. 70-455, 1970-2 CUM. BULL. 297; Rev. Rul. 71-434, 1971 INT. REV. BULL. No. 39, at 14.

49. The Commissioner may also resort to Section 482 as an alternative to the personal holding company or accumulated earnings provisions for forcing earnings out of the corporation. See INT. REV. CODE of 1954, §§ 543(d) (7) (a), 532.

50. See, e.g., Jerome J. Roubik, 53 T.C. 365 (1969). There, a professional service corporation was disregarded for tax purposes and all of its income taxed to its shareholders. In contrast, where the Commissioner does not contest the viability of the professional corporation it is doubtful that a complete allocation of its income to shareholders under Section 482 would be sustained. As indicated by the rejection of total allocations in *Borge* and *Ach*, at least a portion of the income should be attributable to the use of the corporation's equipment and the activities of its other personnel.

51. It has been suggested that the wording is intentionally vague to permit flexibility of administration. Plumb & Kapp, *Reallocation of Income and Deductions Under Section 482*, 41 TAXES 809, 811 (1963).

52. See, e.g., Sections 269 (control means ownership of stock possessing at least 50 percent of all voting power or total value of all stock), 368 (ownership of at least 80 percent of combined voting power and at least 80 percent of total number of shares) and 1551 (at least 80 percent combined voting power or total value of all stock).

poses. The requisite ownership should logically exceed some specified minimum, such as a percentage of voting stock where corporations are involved, but none is provided in either the statute or the regulations. The regulations do discuss control but add little clarification, stating that any kind of control, whether or not legally enforceable, will qualify and that it is the "reality" of control, not its form or mode of its existence, which is determinative.<sup>53</sup>

The phrase "directly or indirectly" creates even more uncertainty. As applied to the control concept, this language embraces a variety of situations. In the corporate sphere, direct control probably includes a situation where the same interests, though holding less than enough stock to "own" the corporation, have enough voting power to control it due to the diffusion of voting power among many interests. Indirect control, then, may include the situation where a party, though having no ownership in a second entity, repeatedly exercises dominance over its activities through economic power or other means. In this regard, the concept of "inferred control"—or for that matter, inferred ownership—is suggested by the statutory language. For example, where a relationship has consistently been found to be mutually influential, such as that of partners or spouses, ownership or control of an entity by one party to the relationship could be inferred from ownership or control of that entity by the other party. Inferred ownership or control is thus analogous to the attribution principles for constructive ownership under Section 318. Again, there is nothing in either Section 482 or the regulations which precludes such an interpretation.

Ownership or control must be held by the "same interests." This phrase seems clearly to contemplate the situation where two entities dealing at non-arm's length are owned or controlled by a single person or by a group of people, such as a partnership or husband and wife. If these are the same interests, then their individual interests in the entities are, in effect, lumped together and then collectively considered in determining whether there is ownership or control. Section 482 could thus be interpreted to cover the situation where individual family members each own separate entities. While none of the family members would personally own any two or more entities, at least in the absence of attribution, the family unit as the "same interests" would own the whole group of entities.

---

53. Treas. Reg. § 1.482-1(a) (3) (1962).



### 1. *Changing Judicial Interpretation*

Despite the possibilities for broad interpretation of the statutory language, the early cases reflected a narrow reading of it, thereby restricting the scope of Section 482. For example, courts appeared to ignore the alternative nature of "owned or controlled" and rejected allocations in the absence of common ownership of the entities, regardless of whether they were, in reality, commonly controlled.<sup>54</sup> Moreover, they refused to apply any type of attribution concept to find common ownership, even as between husband and wife,<sup>55</sup> and did not regard a family group as constituting the "same interests."<sup>56</sup>

In later cases, however, courts adopted a more liberal interpretation. Control and ownership are no longer treated by the courts as a single element, and allocations may be upheld on the basis of control without ownership of any kind.<sup>57</sup> Similarly, courts readily find ownership or control by the "same interests" where members of the same family individually own or control the entities involved.<sup>58</sup>

### 2. *Shifting the Emphasis*

In view of this trend, an anomalous situation existed until recently in the area of jointly owned subsidiaries. In *Lake Erie & Pitt. Ry.*,<sup>59</sup> two competing railroads each owned 50 per cent of a subsidiary corporation which owned and operated a terminal facility shared equally by the parents. Under prior agreements between the railroads, this facility was leased to them at cost, a rate which the Commissioner determined to be inadequate. Interpreting the statutory language narrowly, the Tax Court found that neither railroad held the requisite ownership of the subsidiary.<sup>60</sup>

---

54. *John L. Denning v. Commissioner*, 180 F.2d 288 (10th Cir. 1950).

55. *A.G. Nelson Paper Co.*, 3 CCH Tax Ct. Mem. 914 (1944).

56. *Epsen Lithographers, Inc. v. O'Malley*, 67 F. Supp. 181 (D. Neb. 1946).

57. *Jesse E. Hall, Sr.*, 32 T.C. 390 (1959), *aff'd*, 294 F.2d 82 (5th Cir. 1961).

58. *Grenada Industries, Inc.*, 17 T.C. 231 (1951), *aff'd*, 202 F.2d 873 (5th Cir.), *cert. denied*, 346 U.S. 819 (1953). There, two corporations and two partnerships were owned by four families in identical proportions. Upholding an allocation of income among the four entities, the court declared it immaterial that the legal ownership of the stocks and partnership interests were not in the same persons at the same time.

59. 5 T.C. 558 (1945).

60. The court reasoned:

The question at once arises whether the petitioner and ei-

The court's approach is significant in two respects. First, as in other early cases, the court did not distinguish between ownership and control. Apparently deciding that a 50 per cent stock interest does not constitute ownership, it did not consider whether there could nevertheless be actual control by either parent. Second, it rejected the theory that two entities, which are unrelated except for their joint ownership or control of a third entity, are the "same interests" within the meaning of Section 482.<sup>61</sup>

The *Lake Erie* approach was reaffirmed on similar facts in *B. Forman & Company, Inc.*<sup>62</sup> where two closely held corporations (McCurdy and Forman), with no common shareholders, directors, or officers, owned competing department stores. In an effort to increase business, they formed a third corporation (Midtown) for the purpose of constructing and operating a mall and shopping center adjoining their locations. To finance this project, McCurdy and Forman each made a \$1 million loan to Midtown, which was ultimately evidenced by non-interest bearing notes. No payment of interest or principal was ever made.

The Commissioner allocated interest income to Forman and McCurdy under Section 482, urging that they should be considered as having acted in partnership in organizing and operating

---

ther of the lessee companies are *owned* by the same interests. The New York Central and the Pennsylvania are competing railroad companies. Each of them is *controlled* by its stockholders. The respondent makes no contention that the stockholders of the New York Central, or any considerable number of them, are also stockholders of the Pennsylvania. The stockholders of the New York Central are not the "same interests" as the stockholders of Pennsylvania, and neither the New York Central nor the Pennsylvania has control of the petitioner. Together they do have. But that amounts to saying nothing more than that the stockholders of a corporation control it. We do not think it can be said that where two or more corporations owned by different sets of stockholders control another corporation such other corporation is controlled by the same interests.

*Id.* at 564 (emphasis added).

61. The Commissioner originally acquiesced in the *Lake Erie* decision. 1945 CUM. BULL. 5. This was not withdrawn until 1965, when nonacquiescence was substituted. 1965-1 CUM. BULL. 5. At that time, he took the position that the Tax Court's narrow interpretation of control by the same interests was inconsistent with the broad statutory language and disregarded the "realities of the arrangement." Since the two railroads "were acting in concert, joined by a common interest," the reality of control by the same interests was present "no less than if they had formed a partnership. . . ." Rev. Rul. 65-142, 1965-1 CUM. BULL. 223.

62. 54 T.C. 912 (1970), *aff'd in part and rev'd in part*, 453 F.2d 1144 (2d Cir.), *cert. denied*, 407 U.S. 934 (1972).

Midtown. The Tax Court refused to sustain the allocation. It stated that neither Forman nor McCurdy could alone dominate Midtown, since each held only a 50 per cent interest.<sup>63</sup> Neither could it find a group of common shareholders which could be said to have control of both Forman and McCurdy and thus control of Midtown as well.<sup>64</sup> The court therefore reasoned that there was no control by the same interests, declaring:

To import a *common objective test* into Section 482, and thereby create a theoretical partnership between Forman's and McCurdy's would require an unwarranted elasticized reading of the statutory language.<sup>65</sup>

On appeal, the Second Circuit adopted the Commissioner's reasoning and reversed the Tax Court. Overruling *Lake Erie*, it held that Forman and McCurdy had identical interests in Midtown and that together they exercised the requisite control.<sup>66</sup> It concluded that the statutory requirement of control by the "same interests" was satisfied because, whether or not the two parents were treated as a *de facto* partnership, they did act in concert rather than in competition with respect to Midtown.<sup>67</sup>

In addition to eliminating a haven for corporate tax dodging,<sup>68</sup> the *Forman* decision marks a significant shift in emphasis in regard to the concept of the "same interests." The Tax Court

---

63. *Id.* at 922.

64. *Id.* at 921.

65. *Id.* at 923.

66. Citing the trend toward the use of actual control as the proper test, it declared:

To contend that these parents do not control the child is to fly in the face of reality. They have had complete control of Midtown from the day of conception (its incorporation) throughout the years relevant to this case. Every act of Midtown has been dictated by papa and mamma who, directly or indirectly, have financed its career and controlled its every move.

In apparent disregard of the reality of the circumstances, the Tax Court below looked only to the record ownership of Midtown. Ignored was reality of control of Midtown.

453 F.2d 1144, 1153-54.

67. *Id.* at 1155. The court further relied on the fact that the interest-free loans resulted in a shifting of the respective incomes and tax burdens of Forman, McCurdy, and Midtown. Under the regulations, a presumption of control arises if income or deductions have been arbitrarily shifted. Treas. Reg. § 1.482-1(a)(3) (1962).

68. The *Lake Erie* decision had been criticized as unduly restrictive on the Commissioner by several commentators. Hewitt, *Section 482—Allocation of Income and Deductions Between Related Persons—Up To Date*, N.Y.U. 22ND INST. ON FED. TAX. 381, 384-85 (1964); Hewitt, *Section 482—Allocation of Income and Control Among Related Taxpayers*, N.Y.U. 20TH INST. ON FED. TAX. 463, 472-73 (1962); Plumb & Kapp, *supra* note 51, at 812. See also Comment, 13 WM. & MARY L. REV. 948 (1972).

had rejected the introduction of what it termed a "common objective test" into this area. In ruling that two entities can constitute the "same interests" in regard to one operation, even though they are otherwise in competition, the Second Circuit accepted that test. This acceptance of a "common objective test" could result in an expansion of Section 482. The really critical question may now be whether parties which individually own or control entities not dealing at arm's length constitute the same interests. If such parties are treated as constituting the same interests, inquiries as to inferred ownership or control will be less frequent (and theoretically irrelevant), since the parties together will clearly hold the requisite ownership or control of the entities.<sup>69</sup> A common objective may also be simpler to ascertain and less artificial than inferred control. Thus where several unrelated corporations<sup>70</sup> each hold a minor interest in two cost subsidiaries,<sup>71</sup> it may be relatively easy to show a common business objective of lower production expenses so that Section 482 would be applicable.

The possibilities for extension of Section 482 are even greater, however, if a tax avoidance purpose is alone deemed an adequate common objective. For example: corporation A makes a bargain sale of goods to corporation B which results in greater current profits than B would otherwise have realized, but which B can use advantageously because of a net operating loss carryover. The combined taxes are accordingly less than they would have paid had the sale been at arm's length, and B "splits" his tax saving with A by a subsequent contribution to A's capital. If A and B are owned by only marginally affiliated parties, it would be extremely difficult to infer common ownership or control under the old tests. However, under a liberal application of the "common objective test," these parties would be deemed the "same interests," common ownership would therefore exist, and the Commissioner could allocate accordingly.

---

69. Note, however, that the Second Circuit couched its *Forman* opinion in "control" language, even though the two parent corporations together held complete ownership of their subsidiary. The court may have erroneously equated ownership with control, as the earlier cases had done in another context.

70. The common objective test should logically be applicable regardless of the number of parties involved.

71. These are subsidiaries occasionally formed by competing corporations to supply the parents with materials or services at a price below what they would have cost had each parent purchased them separately.

### C. ALLOCATION OR CREATION OF INCOME?

Section 482 grants the Commissioner power, in the appropriate situation, to "distribute, apportion, or allocate gross income, deductions, credits or allowances."<sup>72</sup> Thus, income actually earned by one member of a controlled group but artificially diverted to another member may be allocated by the Commissioner to the member which earned it. This artificial diversion of income typically occurs when one member realizes gross income from the use of proceeds loaned interest free or the resale of goods transferred at a bargain price from another member. In such situations, application of Section 482 is warranted, and the Commissioner will prevail.<sup>73</sup>

Where, however, the entity benefitted realizes no income from the transaction, the issue arises whether the statutory language authorizes what appears to be the "creation" of income for purposes of an allocation to the other party to the transaction. There are three interpretations of the scope of the Commissioner's authority to allocate in such a situation, which can be illustrated by the following example: A and B are members of a controlled group, and A sells goods to B at less than an arm's length price. The "transactional" approach would require that B realize current income from the resale of those particular goods before an allocation could be made. The "overall" approach would allow an allocation if B realized current income from any source whatever. The Commissioner's position, expressed in the regulations,<sup>74</sup> is that an allocation could be made whether or not B realizes income from this particular transaction or any other source.<sup>75</sup>

#### 1. Background

The first case to deal with this issue was *Tennessee-Arkansas Gravel Co. v. Commissioner*,<sup>76</sup> where the Sixth Circuit re-

---

72. INT. REV. CODE of 1954, § 482 (emphasis added).

73. See, e.g., *Eli Lilly & Co. v. United States*, 372 F.2d 990 (Ct. Cl. 1967).

74. Treas. Reg. § 1.482-1(d)(4) (1968).

75. For an alternative analysis of this issue under somewhat different theories, see Nauheim, *B. Forman & Co., Inc.—A Crucial Test of the Future of Section 482*, 26 TAX LAWYER 107, 112 (1972).

76. 112 F.2d 508 (6th Cir. 1940). In that case, one of two commonly controlled corporations leased equipment to the other for \$1,000 per month. This second corporation operated at a loss the first year and paid no rent. The two corporations then agreed that none would be charged for the second year. Although the second corporation had gross receipts of \$51,427 this second year, it is not clear from the facts whether it had gross income. The Commissioner did not allocate either gross receipts or gross income from the lessee corporation but

jected an allocation under the predecessor to Section 482, stating that it

did not authorize the Commissioner to set up income where none existed. The principal purpose of the section was to clearly reflect income that did exist.<sup>77</sup>

In the line of cases following this decision, the Tax Court appeared to be developing a transactional approach.<sup>78</sup> It was uncertain from the earlier cases, however, whether the allocations were rejected solely on the principle that income could not be created or also on the ground that the Commissioner had failed to make a correlative offsetting adjustment to the income or deductions of the entity from which the allocation was made.<sup>79</sup> The Service sought to use the latter ground as a basis for explaining the adverse decisions and rationalizing its acquiescence to one of them<sup>80</sup> when it issued new regulations covering the

merely added \$12,000 to the lessor corporation's income for the latter year.

In the earlier case of *Asiatic Petroleum Co. v. Commissioner*, 79 F.2d 234 (2d Cir. 1935), *aff'g* 31 B.T.A. 1152, *cert. denied*, 296 U.S. 645 (1935), the court stated in dictum: "The Commissioner is authorized to allocate gross income among trades or businesses under the specified statutory conditions. If there is no gross income there is nothing to allocate." 79 F.2d at 237. Under the facts, however, there was clearly income involved to support the Commissioner's allocation.

77. 112 F.2d at 510.

78. *E. C. Laster*, 43 B.T.A. 159 (1940), *acquiesced in* 1941-1 CUM. BULL. 7; *Smith-Bridgman & Co.*, 16 T.C. 287 (1951), *acquiesced in* 1951-1 CUM. BULL. 3; *Texsun Supply Corp.*, 17 T.C. 433 (1951), *acquiesced in* 1952-1 CUM. BULL. 4. For a more detailed discussion of each case and the development of this line of judicial thought, see Asbill, *The Application of Section 482 to Domestic Taxpayers—Current Status and Trends*, 1967 SO. CALIF. TAX INST., 673, at 690-96; and Seieroe & Gerber, *Section 482—Still Growing at the Age of 50*, 46 TAXES 893, at 902-04 (1967). See generally Jenks, *The "Creation of Income" Doctrine: A Comment on the Proposed Section 482 Regulations*, 43 TAXES 486 (1965).

79. For example, in *Smith-Bridgman*, after holding that Section 45 did not authorize the creation of income, the Tax Court continued:

That the respondent did not "allocate" gross income of Continental to petitioner is apparent, since the record shows that he made no adjustment to the income or deductions of Continental. He argues that no such adjustment was required, since Continental in its taxable year ending January 31, 1944 had no net income. Such argument overlooks the established fact that Continental in the taxable year 1945 did have net income against which it could have applied the additional net operating loss carry-over. While we do not have the tax liability of Continental before us, we think that the respondent has created rather than allocated gross income.

16 T.C. at 294. Thus, it appears that the Tax Court was taking the position that no proper allocation was made, because no reduction had been made in the income of Continental, from whom the income was allegedly being allocated.

80. *Smith-Bridgman & Co.*, 16 T.C. 287 (1951), *acquiesced in* 1951-1 CUM. BULL. 3.

subject.<sup>81</sup> While several commentators apparently accepted the Commissioner's rationale for distinguishing the prior cases,<sup>82</sup> it was not clear whether the courts would also accept it.

## 2. *Judicial Reaction to The New Regulations*

When promulgated in 1968, the new regulations<sup>83</sup> on the creation of income issue were in opposition to both the transactional and overall approaches.<sup>84</sup> *Treas. Reg.* Section 1.482-1(d) (4) states that an allocation may be made even though (1) the transaction giving rise to the allocation produced no current income, (2) gross income may never be realized from that transaction and (3) the entity from which the allocation is made has no gross income from any source.<sup>85</sup>

The next case to consider the creation of income issue, *PPG Industries, Inc.*<sup>86</sup> was being tried when the new regulations went into effect. There, a wholly owned Brazilian holding company

---

81. Regulations were proposed in 1965 but were superseded by new proposed Regulations on August 2, 1966. These regulations were ostensibly proposed to supplement and amplify the arm's length standard in the areas of loans or advances, performance of services, use of tangible property, transfer or use of intangible property, and sales of tangible property between controlled entities. The final regulations were promulgated April 16, 1968 T.D. 6952, 1968-1 CUM. BULL. 218.

The Commissioner's position was stated in T.I.R. 838 (Aug. 2, 1966). This was followed by Rev. Rul. 67-79, 1967-1 CUM. BULL. 117, wherein it was explained:

The acquiescence in *Smith-Bridgman & Co.* was intended only to concur in the proposition that appropriate adjustments are to be made to the incomes of both members of the group affected to reflect the allocation. The acquiescence does not override the Service's position as to the scope and purpose of section 482 . . . as set forth in existing regulations. Similarly, the Service concurs in the result reached in *Tennessee-Arkansas Gravel Co.* only to the extent the holding is based on its failure to have made an appropriate adjustment to the income or deductions to the members of the group from which the allocation was made.

82. See Eustice, *Tax Problems Arising from Transactions Between Affiliated or Related Corporations*, 23 TAX LAW REV. 451, at 489-90 (1968); Plumb & Kapp, *supra* note 51, at 814-15. This was not universally true, though, and some commentators warned against reliance on the alleged distinction. See Seieroe & Gerber, *supra* note 78, at 903-04.

83. *Treas. Reg.* § 1.482-1(d) (2) & (4) (1968).

84. It appears, in fact, that the two examples given in *Treas. Reg.* § 1.482-1(d) (4) (1968) are specifically contrary in result to the decisions in *Texsun Supply Co.* and *Smith-Bridgman & Co.*

85. In accordance with the Commissioner's present position, *Treas. Reg.* § 1.482-1(d) (2) (1968) now requires that a correlative adjustment must be made to the income of the entity from which income is allocated.

86. 55 T.C. 928 (1970).

(Pittsburco) had owed PPG \$546,086 since 1940 as a result of interest-free advances made by PPG prior to and including that date. Pittsburco first realized income in 1960 from dividends, interest, and gains from the sale of bonds. The Commissioner allocated interest income to PPG on the ground that a portion of Pittsburco's 1960 investment income was attributable to PPG's earlier advances. This time a correlative adjustment was made in Pittsburco's income.

The Tax Court rejected the Commissioner's technical distinction of prior cases and reiterated the proposition that there can be no allocation where the commonly controlled businesses realized no income as a result of the particular transaction.<sup>87</sup> It concluded:

We cannot possibly conceive even the most tenuous connection between this 1940 balance and Pittsburco's income some 20 years later . . . <sup>88</sup>

While PPG was definitely another taxpayer victory, the Tax Court's opinion left some uncertainty as to its prospective impact. Notably, the court did not try to reconcile its decision with the new regulation on creation of income.<sup>89</sup> The "tenuous connection" language indicated that the court would continue to follow a transactional approach in such matters, and that any sustainable allocation would have to be based on a realistic nexus between the intercompany transaction and the income-producing event. In finding no such link in PPG the court was primarily concerned with the time element, although this would not seem to be relevant under the rationale of the transactional approach, which theoretically places no limit on the time that may elapse between the bargain transaction and the income realizing event. It is possible that the court was putting the burden on the Commissioner to show some evidence of a nexus and relied on the lengthy time between the initial transaction and the income-

---

87. 55 T.C. at 1010.

88. *Id.* at 1009.

89. There was no indication that the Regulations could not be retroactively applied. See INT. REV. CODE of 1954, § 7805. In fact, the court discussed those portions of the new regulations dealing with the appropriate arm's length interest rate, which were cited on brief by the Commissioner. It specifically declined to rule on whether the Commissioner could ever make an allocation which was in effect an imputation of interest, and nowhere did it deal with the regulation authorizing such an allocation even in the absence of gross income. The court stated that it did not believe Section 482 and the regulations thereunder were to be applied in so broad a manner, but it is not entirely clear which regulations were covered by this statement. 55 T.C. at 1010.



producing event to infer the absence of such a nexus. It was not clear, however, whether the same inference would be drawn if the interval were shorter.<sup>90</sup> The question also remained as to what factors were necessary to find a nexus sufficient to sustain an allocation.

The Tax Court reaffirmed its position in *Huber Homes, Inc.*<sup>91</sup> Charles Huber formed Huber Homes to build and sell family dwellings. A wholly owned subsidiary (Huber Investment) was later created to invest in and rent real estate, and Homes transferred 52 unsold houses to it at cost. Investment then rented the houses to unrelated parties, reporting a gross rental income of \$470,181 but a net operating loss of \$56,518 for the year in question. The Commissioner allocated the difference between the fair market value and the sales price of the houses to Homes and proposed a correlative increase to the basis of the houses in Investment's hands.

The Tax Court held that Section 482 was inapplicable, because the Commissioner was not allocating but creating income.<sup>92</sup> The court reasoned that the Commissioner could not have charged the difference between fair market value and cost as income to Homes if it had itself rented the houses, and Section 482 should not produce a different result merely because Investment rented them. The court apparently felt that only an activity similar in form to the bargain transaction—here a sale—could generate allocable income. It then suggested, rather inconsistently, that an allocation to a bargain seller might be upheld where the “use or consumption” of the goods produced income without resale, but it did not provide an example and merely stated that *Huber Homes* was not one. Again, the court avoided the specific question of the regulations' validity, rationalizing that they were not designed to cover a situation where there was no intention to resell bargain goods outside the group.<sup>93</sup>

---

90. See Crawford, *Are the Courts Expanding the Use of Code Section 482?*, 36 J. TAXATION 150, 152-53 (1972).

91. 55 T.C. 598 (1971).

92. The Commissioner's attempt, as in *PPG*, to distinguish earlier cases on the ground that an appropriate correlative adjustment was made here was expressly rejected. The court stated that the absence of a correlative adjustment was “no more than a possible supporting ground” and not a “controlling reason” for earlier decisions. *Id.* at 610.

93. The court rationalized that:

They plainly contemplate a situation where one member of a controlled group sells to another at less than fair market value and where it is expected that the controlled party would in turn resell the product to a third party. . . . We think that the regulations do not cover the present case where there was

In reaching its decision, the Tax Court again appeared to be relying on the transactional approach, but its opinion was confusing and still left uncertainty as to its exact position. The court did not foreclose the possibility that an allocation would be sustained, even in the absence of current gross income, if there were an intent at the time of the transfer to subsequently resell bargain goods outside the controlled group. It was unclear, however, whether the court was using this merely as a means to distinguish the regulations or was proposing a new test.

Allowing such intent alone to support an allocation without current income would seem to be a deviation from the strict transactional approach, although the Tax Court could possibly still claim adherence to it, since an intent to complete the particular transaction would be required. In some cases, however, this would mean that the existence of a nexus between a current item of income and the initial transaction, which the PPG decision found determinative under the transactional approach, would not be necessary.

In addition, some of the wording of the court's opinion would seem to preclude an allocation where "mixed" transactions are involved. That is, if goods are obtained in a bargain sale, only a subsequent resale, and not a rental, could be considered as generating income from the initial transaction. Similarly, loaned funds would have to be reloaned rather than invested in other income-producing activities. The unreasonableness of such a position is obvious when viewed in conjunction with the court's statements concerning intent. Carried to an extreme, this would permit the court to reject an allocation even where it found that there was an initial intent to resell goods received in a bargain sale, but where they were subsequently

---

no intention to resell the 52 houses in issue, where they were converted to rental use, and where they do not appear to be productive of any net income whatever.

*Id.* at 610. The court apparently derived this interpretation from the "ultimate income anticipated" and "gross income contemplated" language in Treas. Reg. § 1.482-1(d)(4) (1962). In light of the Service's position and the complete absence of any prior reference to taxpayer intent by either the Commissioner or the courts, such a reading is questionable. Even accepting the court's interpretation, its apparent distinction between rental and resale income seems unfounded. The general principle that there must be gross income to sustain an allocation should equally limit the Commissioner's power in such a situation, intent to resell later notwithstanding. This distinction seemingly also led the court to interject the term "net income" throughout its opinion, whereas previous decisions had spoken only in terms of gross income. This is apparently just dictum. See Crawford, *supra* note 90, at 151-52.

rented instead. The court's position thus appears to be internally inconsistent, and its limitation on the use of—or on the intent to use—bargain items is without apparent justification.

*Huber Homes* did little to clarify the Tax Court's transactional approach to the creation of income issue. This may have been due to the court's attempt to apply previously developed arguments to a peculiar fact situation before the court for the first time. Ironically, while the result was a uniquely restrictive application of the transactional approach, the court's opinion left open the possibility of a liberal modification of its strict transactional position.

The uncertainty in this area increased when the Commissioner was finally awarded a victory in *B. Forman Co. v. Commissioner*,<sup>94</sup> the first case to explicitly give solid support to the regulations.<sup>95</sup> The Commissioner in that case allocated income to two corporations which made interest-free loans to their joint subsidiary. The Second Circuit upheld the allocation, accepting the Commissioner's contention that an allocation can be made even in the absence of gross income if the proper correlative adjustments are made to the incomes and deductions of the respective entities.<sup>96</sup> The opinion placed primary reliance on the determination that the Commissioner's power in this area had been significantly expanded by the Revenue Act of 1928,<sup>97</sup> which empowered him to distribute, apportion, or allocate income where he previously could only require corporations to consolidate their returns.<sup>98</sup>

---

94. 453 F.2d 1144 (2d Cir.), *cert. denied*, 407 U.S. 934 (1972). See text following note 62 *supra* for the facts of this case.

95. The court stated that the regulations "must prevail, for they are entirely consistent with the scope and purpose of § 482." 453 F.2d at 1156.

96. The court dismissed the line of previous cases to the contrary as "not in accord with either economic reality or with the declared purpose of Section 482," and stated that "[t]hey seriously impair [its] usefulness. . . ." 453 F.2d at 1156.

97. Revenue Act of 1928, ch. 852, 45 Stat. 806.

98. The authority to consolidate accounts was the extent of the Commissioner's power under the Revenue Act of 1926, ch. 27, § 240(f), 44 Stat. 46. Moreover, the taxpayers themselves could opt for such treatment if tax benefits would result. The Act of 1928, on the other hand, gave the Commissioner power to effect tax results other than a mere "wash-out" of intra-group transactions. It also extended this power to entities which would not have come under the consolidated returns provision and eliminated any taxpayer choice in the matter of its utilization. For a comparison of some tax results under the consolidated return provisions and Section 482, see Farber, *Intercompany Accounting Among Related Companies: Relationship Between Section*

Due to the short shrift given the taxpayers' argument, it is not entirely clear why the Second Circuit decided to break with precedent and place itself in opposition to the Tax Court and the Sixth Circuit. It was without direct support for its *in toto* acceptance of the Commissioner's position,<sup>99</sup> and it can only be conjectured that the court found his approach the most effective implementation of the underlying policy of Section 482.<sup>100</sup>

### 3. *Modification in the Tax Court's Approach*

In spite of the *Forman* victory in the Second Circuit, the Commissioner could reasonably have expected continued stiff opposition in both the Tax Court and other circuits.<sup>101</sup> Two recent decisions indicate, though, that while the Second Circuit may remain alone in unqualifiedly accepting the Commissioner's position, the Tax Court may have slightly shifted its own position.

In *Kahler Corp.*,<sup>102</sup> non-interest bearing loans were made by Kahler to its subsidiaries, which used the funds for working capital during an expansion period. The Commissioner allocated interest income to Kahler solely on the ground that the loans were not made at arm's length and without regard to the ultimate use of the interest-free funds or whether they produced income. The Tax Court summarily denied the allocation, despite its finding that the funds advanced were "unquestionably" used

---

482 and Consolidated Returns Provisions, N.Y.U. 27TH INST. ON FED. TAX. 719 (1968).

99. The court cited for support *National Securities Corp. v. Commissioner*, 137 F.2d 699 (3d Cir.), *cert. denied*, 320 U.S. 794 (1943), and the report of the House Ways and Means Committee accompanying the statutory changes in the Act of 1928. H.R. REP. NO. 2, 70th Cong., 1st Sess. 16-17 (1928). However, the *National Securities* case was not on point, and the House Committee report dealt only with the general scope and purpose of the statute. Neither specifically touched on the creation of income issue, although the committee report does offer indirect support for the court's position. See *Nauheim*, *supra* note 75, at 116-117.

100. The committee report on the 1928 Act states that Section 45 (482's predecessor) was enacted "in order to prevent evasion (by the shifting of profits, the making of fictitious sales and other methods frequently adopted for the purpose of 'milking'), and in order to clearly reflect [the controlled entities'] true tax liability." H.R. REP. NO. 2, *supra* note 99.

101. In fact, this may have been one reason the Commissioner did not appeal *Huber Homes*. The reviewing court would have been the Sixth Circuit, which decided the *Tennessee-Arkansas* case.

102. 58 T.C. 496 (1972). The Commissioner has announced non-acquiescence, and both the taxpayer and the Commissioner will appeal the decision to the Ninth Circuit.

for productive purposes. The Commissioner, it explained, was framing the issue improperly in making an allocation merely on the basis that income would have been realized in arm's length bargaining, rather than asserting that income actually was generated by the funds and improperly deflected.<sup>103</sup> The court rejected *Forman* as incorrectly delineating both the purpose of Section 482 and the circumstances required for it to operate and declared that the regulations reached beyond the intent and purpose of the Section.

Considered alone, *Kahler* would appear to have firmly solidified the Tax Court's transactional approach. But the companion case to *Kahler* indicates that a shift has occurred. *Kerry Investment Co.*<sup>104</sup> involved the allocation of interest income on similar unpaid interest-free loans made by a Seattle holding company to its subsidiary. The subsidiary profitably invested some of the proceeds in real estate ventures and reloaned some to an outsider, but various other portions were invested in non-income producing stock. The remaining funds could not be traced to any specific assets by either the taxpayer or the Commissioner.

The Tax Court allowed the allocation with respect to those funds which were traced to the real estate ventures and the loan. Not surprisingly, it held that no allocation could be made in regard to loan proceeds traceable to non-income producing stock, citing its decision in *Huber Homes*. But when the question of the non-traceable assets arose, the court again sustained the Commissioner's allocation. Rejecting the claim that this was creating rather than allocating income, the court rationalized its decision in terms of the taxpayer's burden of proof. Since the burden was on the taxpayer to prove that the Commissioner's allocation was arbitrary, unreasonable, or capricious,<sup>105</sup> it was incumbent upon him to show that these non-traceable funds did not result in the production of gross income. In the absence of such a showing, the court concluded, the Commissioner's determination must stand. The court found this result to be desirable, since it placed the burden of keeping complete and accurate records on the taxpayer himself, who would naturally have best

---

103. The court restated its position that a prerequisite to a Section 482 allocation "is the existence of an item of income, deduction, credit or allowance which had its genesis in the particular transaction between the related parties." *Id.* at 506.

104. 58 T.C. 479 (1972). This decision will be appealed with *Kahler*, see text accompanying note 102 *supra*.

105. See note 5 *supra*.

access to the necessary information, rather than the Commissioner.

In both *Kahler* and *Kerry*, the court affirmed its position that the Commissioner cannot utilize Section 482 to "create" income solely by imposing an arm's length test to intragroup transactions. Thus the Commissioner's allocation was rejected in *Kahler* on what was apparently only a procedural technicality—his failure to assert that gross income was generated as a result of the particular transaction. Viewed together, the *Kahler* and *Kerry* decisions mark a modification in the Tax Court's transactional approach but also indicate that the court is not ready to adopt a major change in its position.

The modification is in the emphasis on the taxpayer's burden of proof. In both *PPG Industries* and *Huber Homes*, the court had refused to sustain an allocation, because it could find no connection between the bargain transaction and the current gross income realized by the subsidiary. While not rejecting the general rule that the taxpayer must prove the Commissioner's action arbitrary, capricious, or unreasonable, the courts required little of the taxpayer to sustain his burden if the Commissioner could not show such a connection. Impliedly, the onus was on the Commissioner to establish the connection, rather than on the taxpayer to prove its absence.

The tracing concept adopted in *Kerry* is a retreat from this, since it requires a higher standard of proof of the taxpayer and explicitly requires him to show that no income was realized as a result of the bargain transaction. It is now incumbent upon the taxpayer to negate the existence of a connection, rather than upon the Commissioner to establish it. This can be done only by tracing the bargain transaction to non-income producing assets or activities.

The court also seems to have eliminated some of the uncertainties raised in *Huber Homes*. There, the court refused an allocation of rental income to the bargain seller of the houses rented, indicating that income generated by an activity dissimilar to the bargain transaction would not be allocable under the transactional approach. Yet, in *Kerry* allocations were upheld, not only where loaned funds were reloaned, but also where they were invested in other forms of income-producing activities. Thus, the "mixed transaction" restriction appears to have been disapproved. *Kerry* also settled in the affirmative the issue left open in *Huber*: whether income generated from the use or con-

sumption of bargain items could be allocated under the transactional approach.

#### 4. *General Analysis and Criticisms of the Tax Court's Current Position*

The Tax Court's slight modification in the taxpayer's burden of proof, as evidenced by *Kerry* and *Kahler*, presents the distinct possibility that it may eventually adopt an overall approach that allows an allocation of current gross income realized from any source whatsoever. The court will now sustain an allocation of income generated by the use or consumption of bargain items unless the taxpayer can prove the absence of a nexus between such income and the bargain transaction. In some situations the taxpayer's tracing burden will be almost impossible to carry, such as where interest-free funds are contributed to working capital and consumed by operating costs. The court theoretically could still deal with this situation under its modified transactional approach. However, the effect of allowing an allocation where some income is generated and the taxpayer cannot trace the funds to specific non-income producing assets or activities is very similar to the result which would be reached under the overall approach.<sup>106</sup> Significantly, such an outcome is presaged in the *Kahler* case, where the Tax Court indicated it would have upheld an allocation on facts similar to those above if the Commissioner had alleged that the income was generated by the use or consumption of the bargain items rather than relying merely on the existence of a bargain transaction.<sup>107</sup>

The Tax Court's adoption of an overall approach would be welcome. Any bargain transaction between controlled entities will benefit the recipient economically. The rent-free use of buildings, for example, will reduce operating expenses and increase gross income. Or, as the dissent pointed out in *Kerry* and *Kahler*, the proceeds of an interest-free loan, though not themselves used to produce income, may free other funds which do. A subsidiary may purchase real estate which is not currently productive but is necessary for its future operations. If it has received interest-free funds from its parent, it will be able to make the purchase without diverting funds from its working capital as would otherwise be required. Since it can therefore

---

106. See text following note 73 *supra*.

107. One dissenting judge would have gone even further, following the *Forman* decision, and allowed an allocation without current gross income. *Kerry Inv. Co.*, 58 T.C. 479, 494 (1972).

maintain its current level of productivity, it need not incur a reduction in current income. Although ostensibly there has been no increase in the subsidiary's income per se, in reality its income would have been less had there been no bargain transaction. The parent, on the other hand, will lose the interest income it would have received had it loaned the funds at an arm's length rate. Thus, as with the conventional bargain transaction—e.g., bargain sale and resale by the benefited entity—one entity's income has been increased and the other's decreased. Since this is true of all bargain transactions where the tracing is to nonproductive uses, allocations should be utilized in such situations to accurately reflect true taxable income.

The overall approach is preferable to the Commissioner's position that an allocation should be allowed regardless of whether the recipient of bargain items realizes any gross income. Both approaches would eliminate the need for any tracing of funds or materials and would better reflect the economic realities of bargain transactions than the transactional approach. The overall approach, however, only permits an allocation when some item of current gross income is realized,<sup>108</sup> and this would allow the Tax Court to adhere to the apparent statutory requirement that some gross income be in existence for an allocation to be appropriate. On the other hand, the Commissioner's approach could lead to inequitable results since it seemingly ignores the statute's purpose—to insure that income is properly reflected. For example, where prior to its liquidation an insolvent subsidiary receives only enough interest-free loans from its parent to satisfy its creditors, the overall approach would not permit an allocation of interest income to the parent. The Commissioner's approach, however, would permit an allocation even though the subsidiary

---

108. This should be subject to the further limitation, heretofore assumed, that the realized income is equal to or greater than the allocated amount. Thus, where the benefited entity realizes only \$1000 of gross income in the year of the bargain transaction, no more than \$1000 should be allocated. Otherwise, the realization of only a minimal amount of gross income could technically support a complete allocation in the current year, and there would be little justification for distinguishing the overall approach from the Commissioner's approach.

If the benefited entity does not realize current gross income equal to the arm's length amount, then income earned in successive years should logically trigger further allocations pro tanto until the total arm's length charge has been allocated. Theoretically, this method comports with both the purpose and language of Section 482, but it may present substantial practical problems, especially in regard to record keeping, where the individual allocations must be made over several years.



generated no current income and, in fact, would never generate income. Such a result distorts the statutory purpose of clearly reflecting income.<sup>109</sup>

### III. THE RELATIONSHIP OF SECTION 482 TO OTHER CODE SECTIONS AND TAX PRINCIPLES

There are a number of situations similar to those previously discussed which the Commissioner has approached through Section 482 but which are more properly analyzed under other Code sections or judicially established tax principles. The converse has also occurred: the Commissioner has invoked judicial principles or multiple Code sections in addition to section 482 in situations which could have been remedied through application of Section 482 alone. The above practices have tended to obscure the fact that each section has its own appropriate scope and impact in the tax law. When accepted by the courts, this practice can lead to either an undesirably broad or unnecessarily restrictive application of Section 482 and creates instability and uncertainty in the tax law. Consequently, one of the major problems, in recent years especially, has been delineating the boundaries within which Section 482 should operate.

An example of the latter situation is *Rubin v. Commissioner*,<sup>110</sup> where the Second Circuit warned against the Commissioner's practice of using multiple Code sections unnecessarily and rejected this tactic in a situation which it felt clearly called for the application of Section 482 alone. That case involved management fees paid to a close corporation for the personal services of its controlling shareholder. The Commissioner attempted to tax the corporation's income directly to the shareholder, initially advancing arguments under both Section 482 and Section 61.<sup>111</sup>

---

109. For the reasons given, it has been suggested that if there is any justification for implementing the Commissioner's approach, that result should be achieved through legislation rather than administrative expansion of the Code. Lewis, *Tax Court in Huber Homes holds that the IRS may not use 482 to create income*, 34 J. TAXATION 208 (1971); Comment, 9 WM. & MARY L. REV. 509, 519 (1967).

110. 429 F.2d 650 (2d Cir. 1970). See text accompanying notes 28-35 *supra*.

111. The Commissioner may have been led to believe that this was the proper approach by the decision in *George Cukor*, 27 CCH Tax Ct. Mem. 89 (1968). There, a motion picture director's wholly owned corporation sold his services at a profit. To avoid personal holding company tax, this corporation paid a dividend to its newly created subsidiary. The Commissioner claimed that this was a sham transaction and tried to tax the dividend to the individual. Although the Tax Court upheld the taxpayer's arrangement, it strongly indicated that the Com-

The Tax Court upheld the allocation under assignment of income and "substance over form" principles without even reaching the Section 482 issue. It held that Rubin, rather than his corporation, was the "true earner" of the management fees, and "in substance" he worked directly for the other corporation.

Reversing and remanding, the Second Circuit held that the Tax Court had erroneously neglected Section 482. It admonished that:

Resort to "common law" doctrines of taxation and the broad sweep of § 61 may occasionally be useful in connection with "transactions heavily freighted with tax motives" which cannot be satisfactorily handled in other ways . . . but they have no place where, as here, there is a statutory provision adequate to deal with the problem presented.<sup>112</sup>

The court found that Section 482 was the appropriate statutory provision and clearly superior to the "blunt tool" employed by the Tax Court.<sup>113</sup> It apparently felt that once Section 61 is applied to a case in a particular area, there is the danger that this will unintentionally "open" the area to the broad judicial concepts associated with that section, whether appropriate or not.

Despite the admonitions of the Second Circuit, there appears to be no move to effectively delineate the precise scope of Section 482 in relation to other Code sections and tax principles. Instead, recent cases indicate that the use of "blunt tools" will continue.

#### A. INCURSIONS OF SECTION 482 INTO INAPPROPRIATE AREAS

The confusion which can result from application of Section 482 where another Code section should have been used is illustrated in *Marc's Big Boy-Prospect, Inc.*<sup>114</sup> and *Your Host, Inc.*<sup>115</sup> In *Marc's Big Boy*, a corporation, Wisconsin Big Boy (WBB), obtained a restaurant franchise for Wisconsin. It then established wholly owned subsidiary restaurants for the purpose of setting up each under a subfranchise agreement. WBB did not actually operate the individual restaurants but supervised their operation and performed services for them for a fee. The Com-

---

missioner would have been successful if he had allocated the income itself directly to the individual under Section 61 assignment-of-income principles.

112. 429 F.2d at 653.

113. *Id.*

114. 52 T.C. 1073 (1969), *aff'd. sub. nom.*, Wisconsin Big Boy Corp. v. Commissioner, 452 F.2d 137 (7th Cir. 1971).

115. 58 T.C. 10 (1972). This decision is on appeal to the Second Circuit by both the taxpayer and the Commissioner.

missioner proceeded against WBB on three grounds. He gave notice under Section 61 that the corporate entities of the subsidiaries were to be disregarded for tax purposes and all their income and deductions attributed to WBB. He also allocated all income and deductions to WBB under Section 482. Finally, the Commissioner disallowed the subsidiaries' surtax exemptions under Sections 269 and 1551 on the ground that the enjoyment of multiple exemptions was the major purpose for operating through multiple corporations.<sup>116</sup>

The Tax Court purported to dispose of the case on Section 482 grounds. The Commissioner, however, had not based his allocations on any particular non-arm's length transactions and only "suggested" that certain transactions failed to satisfy the arm's length standard.<sup>117</sup> At trial, the real issue became whether the subsidiaries were formed and operated as separate taxable entities.<sup>118</sup> The court expressly found that the subsidiary restaurants were not shams and that their corporate independence had not been disregarded. Nevertheless, it sustained the Commissioner's 100 per cent allocation to WBB and held:

[T]he record sustains the Commissioner's determination that WBB generated the income for the year in issue by conducting an integrated business enterprise through its divisions set up as wholly owned subsidiary corporations.<sup>119</sup>

Thus the court seemed to conclude that a Section 482 allocation could be based on the mere existence of this type of multiple corporate structure, even without the showing of specific non-arm's length transactions.<sup>120</sup> That the apparent impact of this

---

116. Section 269 deals with acquisitions of corporate entities primarily to obtain the benefits of deductions, credits, or allowances not otherwise available. Section 1551 deals with the creation of corporations to obtain surtax exemptions and improper accumulations of surplus credits.

117. 52 T.C. at 1094.

118. *Id.*

119. *Id.* at 1104 (emphasis added). On appeal of *Marc's Big Boy-Prospect, Inc.*, the Seventh Circuit also claimed to premise its decision on Section 482, but again the organizational nature of the business was the crucial factor. It reasoned that the segments of the business were so interdependent that it was doubtful whether unrelated entities dealing at arm's length would have arrived at a comparable division of functions. It therefore upheld the complete allocation even though the Commissioner did not attempt to reconstruct any of the intercorporate transactions according to the arm's length standard. *Wisconsin Big Boy Corp. v. Commissioner*, 452 F.2d 137 (7th Cir. 1971).

120. Section 482's stated purpose of placing controlled taxpayers on a tax parity with uncontrolled taxpayers logically presupposes the recognition of separate tax entities. See, e.g., *Advance Mach. Exch., Inc. v. Commissioner*, 334 F.2d 1006, 1008 (2d Cir.), *cert. denied*, 334 U.S. 835

result was not lost on the Commissioner was exhibited by his reaction, shortly thereafter, to a similar situation.

In *Your Host, Inc.*, one corporation initially operated a series of restaurants, and additional restaurants were subsequently established through ten new corporations. Also incorporated were a central commissary, a holding company to own and operate the real estate on which the restaurants and commissary were located, a bakery, and a vending machine company. As in *Marc's Big Boy*, the Commissioner utilized Section 482 to allocate all of the income and deductions of the ten other restaurant corporations and the vending machine company to the original corporation.

This time, however, the Tax Court ruled that he had abused his discretion and sustained only part of the allocations. It held that the other ten restaurant corporations were viable economic entities which earned their own income and that Your Host provided no service or benefit to them without adequate compensation and thus a complete allocation was therefore unwarranted, regardless of the motives for using multiple corporations. Section 482, it stated, was not designed to deal with any prohib-

---

(1952). On this basis, the early decisions rejected the Commissioner's attempts to base an allocation of net income solely on the existence of a highly integrated multicorporate enterprise. See, e.g., *Chelsea Products, Inc.*, 16 T.C. 840 (1951), *aff'd*, 197 F.2d 620 (3d Cir. 1952); *accord*, *T.V.D. Co.*, 27 T.C. 879 (1957).

Such allocations were later allowed where the separate entities of a "highly integrated" business served no business functions of any consequence. In these cases, the personnel of the corporation to which income was allocated in fact produced the income, and the corporate shell from which the income was allocated was really a sham. *Hamburgers York Road*, 41 T.C. 821 (1964); see *Charles Town, Inc. v. Commissioner*, 372 F.2d 415 (4th Cir. 1967); *J. R. Land Co. v. United States*, 361 F.2d 607 (4th Cir. 1966); *Spicer Theater, Inc.*, 44 T.C. 198 (1964), *aff'd*, 346 F.2d 704 (4th Cir. 1965). On the other hand, a complete allocation of net income among the entities of a multicorporate enterprise was considered improper where there was a valid business purpose for the existence of the separate businesses. *W. Braun Co. v. Commissioner*, 396 F.2d 264 (2d Cir. 1968); see *Phillip Bros. Chemicals, Inc. v. Commissioner*, 435 F.2d 53 (2d Cir. 1970).

In the present case, however the Tax Court seemed to conclude that WBB generated the entire net income of the enterprise merely because it exercised extensive control over its subsidiaries. For the first time, the court thereby made the existence of an integrated enterprise itself a determinative factor in a Section 482 allocation. For a more detailed discussion of the background to, and a criticism of, the *Marc's Big Boy* decision, see Lee, *Section 482 and the Integrated Business Enterprise*, 57 Va. L. Rev. 1376 (1971).

The court also failed to discuss Sections 269 or 1551, even though both are directly aimed at abuses in this type of situation. See text accompanying notes 126-27 *infra*.

ited activities except the shifting of income among controlled entities.<sup>121</sup> Apparently realizing that its own *Marc's Big Boy* opinion had given a different impression, the court went to some length to explain that case. It recognized that a large portion of its earlier opinion was devoted to detailing the integration of the entities as a single business enterprise. Nevertheless, the court claimed that the allocation to WBB was not sustained because of the organizational form of the enterprise but because there was no proof that WBB and its subsidiaries dealt at arm's length. "[W]e believed," it rationalized, "that it was clear that we were not using section 482 to penalize the petitioners merely for operating a single business through several corporations but to reflect the fact that subsidiaries were being used to distort the amount of income reported by WBB . . . ." <sup>122</sup>

It is difficult to see how the Tax Court could have expected either taxpayers or the Commissioner to perceive this as the actual holding in *Marc's Big Boy*. The Tax Court itself stated that the primary issue was the viability of the entities rather than the existence of specific income distorting transactions, and the questions of non-arm's length dealing was considered only in regard to the division of functions among the entities. The definite impression which had been given in *Marc's Big Boy* was that an artificially divided enterprise would be especially vulnerable to attack under Section 482, with the result being a complete allocation of the income and deductions of the artificially separated entities to a single dominant member.<sup>123</sup>

If the Tax Court had admitted that Section 482 was in fact being used this way in *Marc's Big Boy*, it would have also had

---

121. *Your Host, Inc.*, 58 T.C. 10, 23-24 (1969).

122. *Id.* at 25. The court then attempted to distinguish *Marc's Big Boy* on the ground that each of the corporations in *Your Host* was a viable entity, earning its own income and directly paying its own expenses. The distinction is puzzling, however, since WBB's subsidiaries were also found to be separate viable entities. Moreover, the court stated that the *Your Host* enterprise constituted as much a single integrated business as did the enterprise in *Marc's Big Boy*.

123. The Commissioner conceded on appeal in *Wisconsin Big Boy v. Commissioner* that the mere existence of an artificially divided enterprise does not call for automatic application of Section 482. He obviously felt, however, that his victory gave him broad powers in such situations. As the Tax Court later noted in *Your Host*, "The facts of this case have many similarities to those of *Marc's Big Boy-Prospect, Inc.*, . . . under which [the Commissioner] believes his allocations under section 482 can be supported without question." *Id.* at 23. See also Lee, *CA-7's Wisconsin Big Boy Case Has Dire Implications in 482 Area*, 36 J. TAXATION 349, 350-51 (1972).

to acknowledge the distorted application there of the arm's length standard. The courts in *Marc's Big Boy* were using the arm's length standard, not to test particular intercorporate dealings, but to judge the propriety of the multiple corporation form. Having found that this was not the type of corporate structure which would have been established by unrelated parties dealing at arm's length, they seemed to assume that income was therefore being distorted. If this were true, it would mean a completely novel and unwarranted use of the arm's length test. The regulations distinctly contemplate use of this standard in regard to individual transactions.<sup>124</sup> In addition, it is well settled that the Commissioner may allocate, not because there is power to shift income, but because there has been actual shifting of income or deductions.<sup>125</sup> Fortunately, the Tax Court sought to clarify its position in *Your Host*.

As the court emphasized in its opinion there, Section 482 is not intended to remedy all tax distortions effected through controlled multiple corporations. It specifically authorizes the Commissioner to unscramble a situation where controlled entities have artificially shifted income among themselves and allocate to each entity the actual income earned by it. The motives for using multiple entities are, in this case, irrelevant. On the other hand, where several controlled corporations do deal with each other at arm's length, but where tax avoidance motives for establishing or acquiring them predominates then it would be appropriate to disallow separate deductions, credits, or allowances in general under Section 269 or to disallow separate surtax exemptions and accumulated earnings credits in particular under Section 1551. In the extreme case where the corporations are not operating as separate entities but are actually part of a single entity, then Section 61 principles, such as "sham incorporation" or "substance over form" can be invoked.<sup>126</sup> To confuse these separate situations and indiscriminately apply one Code section or tax principle where another should be utilized distorts the purpose for which each was intended and merely adds uncertainty to the law and increases the chance of inconsistency in situations which should yield similar results.<sup>127</sup> Thus a series of

---

124. Treas. Reg. § 1.482-1(d) (1) (1964).

125. See, e.g., *Bush Hog Mfg. Co.*, 42 T.C. 713 (1964).

126. See Note, *Allocation of Income Among Controlled Taxpayers-Section 482 Rather than Section 61*, 45 TUL. L. REV. 635 (1971).

127. See Westphal, *The Treatment of Income and Deductions in the Case of Controlled or Related Entities*, 9 WM. & MARY L. REV. 1041 (1968).

decisions in which the imprecise application of Section 482 is allowed could lead to results much more severe than the statute was intended to impose. In *Marc's Big Boy*, for example, this meant complete allocations of income and deductions simply on the basis of corporate form and in the absence of sufficient non-arm's length transactions to otherwise support such allocations.<sup>128</sup>

#### B. INAPPROPRIATE RESTRICTIONS ON SECTION 482 BY THE SUPREME COURT

The Commissioner, as well as the taxpayer, can be hurt by the failure to recognize the proper scope and purpose of Section 482, as illustrated in the Supreme Court's recent decision in *Commissioner v. First Security Bank*.<sup>129</sup> The taxpayers were two national banks controlled by a holding company which also controlled a management company and an insurance agency.

Beginning in 1948, the banks made credit life insurance available to their borrowers using unrelated insurance companies.<sup>130</sup> In 1954, the holding company incorporated its own subsidiary insurance company in anticipation of the enactment of preferential tax rates for life insurance companies. In accordance with a plan proposed by an independent insurer, the banks continued to offer credit life insurance as before but began

---

128. By accepting the invocation of Section 482 under a generation of income theory, the Tax Court deprived the taxpayers of the "substantial business" defense which would be available against a "sham" attack under Section 61. See *Moline Properties, Inc. v. Commissioner*, 319 U.S. 436 (1943). Its failure to require the application of Sections 269 and 1551 also allowed the Commissioner to escape the limitations of these sections.

129. 405 U.S. 394 (1972).

130. A standard procedure was followed in offering this insurance. The bank's lending officer (not a licensed agent) would explain the function and availability of credit insurance to the borrower. If the borrower desired coverage, the form was completed, a certificate of insurance issued, and the premium collected or added to the loan. Completed forms and premiums were forwarded from the bank to Management Company which recorded the purchase and sent the premiums to the independent carrier. Management Company also processed claims filed under the policies. The cost of the services rendered by the banks and Management Company was "negligible," about \$2,000 a year.

The Tax Court determined that the reasons for providing the service included: (1) offering a service increasingly supplied by competing financial institutions; (2) obtaining the benefit of additional collateral which credit insurance provides by repaying the loan on the borrower's death or disability; and (3) providing an additional source of income—part of the premiums. 405 U.S. at 396.

sending the premiums and policies directly to the independent insurer which then reinsured the policies with the newly formed insurance company. The banks were prohibited by federal banking law from receiving sales commissions from the insurer<sup>131</sup> and, in fact, received none. The new insurance company, however, received 85 per cent of the premiums from the insurer for assuming the risks on the policies. It reported the reinsurance premiums as income at the preferential rates accorded to insurance companies.<sup>132</sup> Because of these special rates, the total amount of tax paid by the holding company's controlled group was less than it would have been if the banks had claimed or received the commissions.<sup>133</sup> Acting under Section 61 and Section 482, the Commissioner allocated 40 per cent of the subsidiary insurance company's premium income to the banks as compensation for originating and processing the insurance.

The Tax Court upheld the allocation on the ground that since the banks "generated the business," they were taxable on an amount equal to the usual sales commission income.<sup>134</sup> However, the Tenth Circuit reversed,<sup>135</sup> expressly rejecting the generation of business rationale. The acceptance of such a theory, it claimed, would have "alarming consequences" on many normal business practices such as security commission give-ups and all types of referral business.<sup>136</sup> On appeal the Supreme Court did not focus on the generation of business issue. It decided the case on the completely different ground that, since the banks did not receive, and legally could not receive, sales commissions, no part of the reinsurance premiums could be allocated to them.<sup>137</sup>

---

131. 12 U.S.C. § 92 implicitly prohibits banks in places having a population in excess of 5,000 inhabitants from acting as insurance agents. *Id.* at 401.

132. Both the Life Insurance Company Tax Act for 1955, 70 Stat. 36, and the Life Insurance Company Income Tax Act of 1959, 73 Stat. 112, accorded preferential tax treatment to life insurance companies. *Id.* at 399 n.6.

133. Under the existing tax rates, assuming both the banks and Management Company had income in excess of \$25,000, without the commissions, such an allocation would have had no effect on the total taxes paid by Holding Company's subsidiaries. *Id.* at 397 n.2.

134. 26 C.C.H. Tax Ct. Mem. 1320 (1967). This reasoning had previously been approved, on similar facts, by the Seventh Circuit in *Local Finance Corp. v. Commissioner*, 48 T.C. 773 (1967), *aff'd*, 407 F.2d 629 (7th Cir.), *cert. denied*, 396 U.S. 956 (1969).

135. *Commissioner v. First Security Bank*, 436 F.2d 1192 (1971).

136. *Id.* at 1197.

137. In limiting its decision to the narrow illegality issue, the Court failed to reach the broader issue of whether the mere generation of



The Court, per Mr. Justice Powell, phrased its position in terms of general tax principles. Relying on dicta from two earlier cases, it declared:

In cases dealing with the concept of income, it has been assumed that the person to whom the income was attributed could have received it. The underlying assumption always has been that in order to be taxed for income, a taxpayer must have complete dominion over it.<sup>138</sup>

Thus, in the present case, the Commissioner could only allocate income if the holding company did in fact have "complete power" to shift income and exercise it in such a way that the true taxable income of a subsidiary was understated. Since the holding company could not have shifted income among its subsidiaries without violating federal banking laws, the Court concluded that the necessary control over the income was lacking.<sup>139</sup> It then dismissed the Commissioner's arm's length argument, reasoning that even if these entities had not been related, no commissions or premiums could have been legally received and there would still have been no income. The result therefore actually did place these controlled taxpayers on a parity with similarly situated uncontrolled taxpayers in accord with Section 482's purpose.

Justices Marshall and Blackmun dissented, rejecting the majority's emphasis on the prohibition against the banks' actually receiving the allocated income, and concluding that Section 482 was applicable. Mr. Justice Marshall contended that the relevant banking statute prohibited not just the receipt of insurance sales commissions by the banks but also the activities which generated this income. Since the banks admitted actively solicit-

---

business justifies an allocation of income to the generator. The Court did indicate, however, that it tended to agree with the Tenth Circuit's position that the origination or referral of business does not "necessarily" result in taxable income to the originator. 405 U.S. at 401 n.11. Its equivocal support for this position and the fact that it was delivered by way of dictum, though, failed to settle the matter, and some uncertainty still exists.

138. 405 U.S. at 403. This concept that income implies dominion or control, the Court found, is even recognized in Treas. Reg. § 1.482-1(b) (1) (1962).

139. Those cases holding the proceeds of criminal activities to be taxable, *James v. United States*, 366 U.S. 213 (1961), and *Rutkin v. United States*, 343 U.S. 130 (1952), were distinguished on the grounds that here (1) there was no actual receipt of income and (2) the act generating the income, the originating and referring of insurance, was itself legal. This case, the Court stated, was more like *L.D. Shunk Latex Products, Inc. v. Commissioner*, 18 T.C. 940 (1952), where the Tax Court also rejected an allocation of income to an entity legally prohibited from receiving it.

ing the insurance, the legal violation was a *fait accompli*.<sup>140</sup> The controlled group as a whole, he noted, obviously had the right to the proceeds, and the Commissioner was properly attempting to ensure that they were equitably allocated. Mr. Justice Blackmun could find no authority for the majority's attempt to equate the illegality of receipt of income with inability to tax it, which he thought reminiscent of the short-lived claim of right doctrine. Section 482, he maintained, surely contemplates taxation of income without its formal receipt, and it was therefore unimportant that the commissions did not actually flow through the banks.<sup>141</sup>

While the Court ostensibly decided the case under Section 482, its whole approach to the problem was influenced by Section 61 assignment of income and claim of right concepts. By injecting such notions into its consideration of the case, the majority failed to give adequate weight to the fact that the entities here were related members of a single group within which income was being generated and shifted to one member which received preferential tax treatment. It also lost sight of the fact that Section 482 may be properly invoked even where income shifting does not amount to tax evasion. In the *First Security Bank* situation, allocation of the income to the bank, which actually performed the services, is clearly within the scope of Section 482. It is significant that Congress, in enacting preferential treatment for life insurance companies, believed that Section 482 would be available to correct potential abuses in this area.<sup>142</sup>

---

140. 405 U.S. at 413. Mr. Justice Marshall found relevant those cases holding that a taxpayer may be taxed on illegally earned income. To distinguish those cases on the ground that the banks did not receive the commissions, while another member of the controlled group did, would, he declared, "give undue weight to the absence of technical temporary possession of money and some abstract concept of a 'right' to receive it." *Id.* at 416.

141. *Id.* at 418. Justice Blackmun found several examples from other areas of the tax law which demonstrated to him that taxability without receipt is common and that there could indeed be taxation of income without complete dominion over it. While it was true, he noted, that no decision had extended taxation without receipt to a situation where the taxpayer was prohibited from receiving the income, it was also true that no court had refrained from going that far. *Id.* at 424.

142. There is a potential abuse situation in the case of the so-called captive insurance companies. It may be possible for a finance company, for example, to establish a subsidiary life insurance company that will issue life insurance policies in connection with the business of the parent. If the subsidiary charges excessive premium on this business, a portion of the income of the parent company can be diverted to the life insurance company. It is believed that section 482 of the Internal

As to the legal restriction on the receipt of income, it has already been recognized, at least impliedly,<sup>143</sup> that such restrictions are not determinative on Section 482 issues.

The effect of the decision in *First Security Bank* is to subject the Commissioner's power under Section 482 to judicial limitations developed under Section 61. This is unfortunate in two respects. It not only renders the statute less efficacious in dealing with the problem of clearly reflecting the income of controlled entities but also demonstrates that, at least for the time being, there will be no attempt to require the use of Section 482 in a more consistent and precise fashion.<sup>144</sup> As a result, the appropriate scope of Section 482 may be further clouded.

### C. THE ROLE OF SECTION 482

Where the application of Section 482 is appropriate, there are several reasons for requiring its utilization alone rather than resorting to other Code sections and general judicial principles. Section 482 allows more flexibility in dealing with the diverse situations likely to arise in regard to controlled entities. For example, where there is no doubt as to the viability of the entities involved, the court is not faced with an all-or-nothing choice as is usually the case when Section 61 theories are invoked. Thus, as both *Ach* and *Borge* illustrate, it can be used to allocate an ap-

---

Revenue Code of 1954 (relating to allocation of income and deductions among related taxpayers) provides the Secretary of the Treasury ample regulative authority to deal with this problem.

H.R. REP. NO. 1098, 84th Cong., 1st Sess. 7 (1956); S. REP. NO. 1571, 84th Cong., 2d Sess. 8 (1956), cited in 405 U.S. at 524 n.14.

143. *South Texas Rice Warehouse Co.*, 43 T.C. 540 (1965), *aff'd in part and rev'd in part*, 366 F.2d 890 (5th Cir. 1966), *cert. denied*, 386 U.S. 1016 (1967). There, a partnership and corporation were owned by four families. Due to the distribution of ownership interests, the same group of individuals controlled the partnership absolutely, but owned only 65 per cent of the corporation. The corporation rented facilities to the partnership at a non-arms length rate, and the Commissioner allocated income to the corporation. The taxpayers claimed that the requisite common control by the same interests did not exist. Local law, they argued, prohibited a corporation from leasing substantially all of its assets without the approval of 80 per cent of its shareholders and here the shareholder-partners only constituted 65 per cent of those shareholders. Nevertheless, the Tax Court upheld the allocation, finding "actual control" for Section 482 purposes, in spite of the limitations of the local law.

144. One commentator, however, has praised this decision as "a taxpayer bill of rights with respect to overriding principles of taxpayer disability and taxpayer volition," Teschner, *First Security Bank of Utah Taxpayer Disability and the Supreme Court*, 50 TAXES 260, 267 (1972).

appropriate portion of income from a corporation to its shareholder-employee to reflect his contribution in generating that income. Similarly, where there is a series of non-arm's length transactions among several controlled entities, corresponding allocations can be made to reflect the precise proportion of the group's total income which was earned by each. In both situations, true taxable income can be allocated without even approaching the question of whether the corporations are valid rather than mere shams. Moreover, specific relief provisions are available to taxpayers to alleviate some of the unnecessarily harsh consequences which might otherwise result from an allocation. For example, revenue procedures have been promulgated to obviate the possibility of double taxation where foreign tax authorities refuse to give effect to an allocation of income from a foreign to a domestic corporation.<sup>145</sup> In many cases, the specific nature of an allocation is unclear, and the result is that courts frequently rationalize their decisions in overly broad terminology, such as that characteristic of Section 61 concepts.<sup>146</sup> Requiring the use of Section 482 will compel the Commissioner to more precisely set forth the fact patterns upon which he bases his attacks.

#### IV. CONCLUSION

Recent developments in regard to Section 482 are indicative of the uncertainty which still prevails in this area of taxation. Viewed against the background of the *Ach* case, the decision in *Richard Rubin* forewarns of the dangers of allocations to shareholder-employees of close corporations generally. The shifting emphasis under the common ownership or control requirement from the control inquiry to the issue of which parties may constitute the same interests may presage broadened application of Section 482. The 1968 regulations are still in opposition to judicial authority on the creation of income issue, but the decisions in *B. Forman Company* and *Kerry Investment* indicate that the Second Circuit has decided to follow the Regulations and that the Tax Court has modified its transactional approach to the

---

145. Rev. Proc. 70-18, 1970-2 CUM. BULL. 493; Rev. Proc. 65-17, 1965-1 CUM. BULL. 833; Rev. Proc. 65-54, 1964-2 CUM. BULL. 1008. For the operation of these, see Aland, *Section 482: 1971 Version*, 49 TAXES 815, at 841-48 (1971).

146. See, e.g., *Hamburgers* York Road, 41 T.C. 821 (1964) (holding similar to *Marc's Big Boy* but couched in terms of "sham" and "tax avoidance"). See generally the cases cited in note 120 *supra*.

problem. On the other hand, the Supreme Court's decision in *First Security Bank* may mean that the courts will now assert traditional non-statutory limitations on the Commissioner's power, as was done within the area of legal prohibitions against receipt of income. As a result of these uncertainties it can be expected that litigation in this area will increase, with taxpayers seeking judicial restraint in delineating the boundaries of the broad powers embodied in Section 482.